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What does 'utmost good faith' mean?

In English insurance law the duty of utmost good faith separates the insurance law principles from contract law principles for the reason that whilst the former requires volunteering material facts before the contract was concluded, the latter does not impose such an obligation on the contracting parties. The duty of disclosure was first recognised by Lord Mansfield in *Carter v Boehm*¹ and it has continually been developed by the case law for centuries. The duty was first codified (together with the duty not to misrepresent material facts at the pre-contractual stage) by sections 18-20 of the Marine Insurance Act 1906.² Recently the English Insurance Act 2015³ repealed⁴ sections 18-20 of the MIA 1906 but retained and therefore re-codified some of the principles established under these sections already. Under the 2015 Act the pre-contractual duty of utmost good faith is renamed as the 'duty of fair presentation of the risk'. Moreover, the 2015 Act codified some of the common law principles⁵ developed since the MIA 1906 came into force and also brought clarifications to some issues such as 'knowledge of insurer'⁶ and 'knowledge of assured'⁷ in relation to the fair presentation of the risk. Major changes have been introduced on the remedy for breach of the pre-contractual fair presentation of the risk.⁸ Part of section 17 of the MIA 1906 was repealed but the first sentence of the section ie "A contract of marine insurance is a contract based upon the utmost good faith" was left unscathed. Thus, before and after the 2015 Act contracts of marine insurance (and non-marine insurance)⁹ are contracts based upon the utmost good faith. Under the MIA 1906 it was discussed whether section 17, ie the duty of utmost good faith, was illustrated exhaustively¹⁰ by sections 18-20 of the MIA 1906.¹¹ The 2015 Act, by renaming the pre-contractual duties as the duty of 'fair presentation of the risk' and retaining the first sentence of section 17 of the MIA 1906 has clarified that the duty of utmost good faith is not confined to the duty of fair presentation of the risk only. Before the 2015 Act controversies arose mostly because the only remedy, which could be draconian in some circumstances, for breach of the duty of utmost good faith was the avoidance of the contract *ab initio*. The 2015 Act introduced series of remedies for breach of the fair presentation of the risk in proportion to the seriousness of the breach.¹² The duty of fair presentation of the risk derives from the duty of utmost good. As the case law illustrated the scope of the duty of utmost good faith is broader than the pre-contractual duties. Its implications have been discussed by English courts¹³ in various different contexts in

¹ (1766) 3 Burr. 1905.

² MIA 1906 hereinafter.

³ The 2015 Act hereinafter.

⁴ The Insurance Act 2015 section 21(2).

⁵ For instance inducement has become a statutory test under the Insurance Act 2015 section 8(1).

⁶ Section 5

⁷ Section 4

⁸ The Insurance Act 2015 introduced proportionate remedy depending on the breach being deliberate or reckless or neither deliberate nor reckless. See Schedule 1.

⁹ The principles of the duty of good faith under the MIA 1906 applied to marine and non-marine insurance *Joel v Law Union & Crown Insurance Co* [1908] 2 K.B. 863; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2003] 1 A.C. 469, Lord Hobhouse, para 4. (*The Star Sea* hereinafter).

¹⁰ Colinvaux's Law of Insurance, Sweet and Maxwell, 2016, para 6-004.

¹¹ *The Star Sea* [2003] 1 A.C. 469; *K/S Merc-Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563.

¹² The Insurance 2015 Schedule 1.

¹³ As seen in the following paragraphs.

which the definition of good faith, the scope of the duty of good faith and remedy for its breach have been referred to but determined authoritatively. In this article the meaning of the 'utmost good faith' will be discussed and different forms of illustrations of the 'utmost good faith' in the contractual relationships between insurer and assured will be analysed.

Development of the duty of utmost good faith

The rationale for adopting the duty of disclosure is that when the assured conceals material facts the insurer agrees to insure on the false estimate of the risk.¹⁴ Lord Mansfield said in *Carter v Boehm*:¹⁵ "Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only; the under-writer trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist, and to induce him to estimate the risque, as if it did not exist. The keeping back such circumstance is a fraud, and therefore the policy is void."¹⁶ Although the suppression should happen through mistake, without any fraudulent intention; yet still the under-writer is deceived, and the policy is void; because the risque run is really different from the risque understood and intended to be run, at the time of the agreement." His Lordship added that the rule about duty of disclosure is to provide fair presentation of the risk and also to prevent fraud and to encourage good faith.¹⁷

In the nineteenth century the cases referred to the 'duty of utmost good faith' to express the 'pre-contractual duty of disclosure' and the 'duty not to misrepresent material facts'.¹⁸ Those cases also expressed that the parties are subject to the duty of good faith throughout their contractual relationship.¹⁹ The MIA 1906 codified the principles set out over 2000 cases decided before the beginning of the twentieth century. Section 18 set out duties in relation to the pre-contractual disclosure; the agent's duty of disclosure was codified by section 19 and misrepresentation was referred to under section 20. Section 17, as well as confirming that contracts of marine insurance are contracts based upon the utmost good faith, added that if the parties do not observe good faith the contract is avoidable. Sections 18-20 did not refer to any remedies for breach of the pre-contractual duties as set out by the relevant sections. The courts applied the remedy stated under section 17 and the insurers who proved the assured's breach of the pre-contractual duties with regard to the representation of the risk were entitled to avoid the contract. Avoidance was the only recognized remedy under English law for breach of the pre-contractual duties. Demands on alternative remedies, such as claiming damages for the breach instead of avoiding the contract *ab initio*, were rejected by the Courts.²⁰

The duties as set out under the MIA 1906 were therefore called a one way street²¹ for

¹⁴ (1766) 3 Burr. 1905.

¹⁵ (1766) 3 Burrow 1905, 1909.

¹⁶ As the law developed the remedy for breach of the pre-contractual duty of utmost good faith became 'avoidance' of the contracts. *Pawson v Watson* (1778) 2 Cowp. 785.

¹⁷ (1766) 3 Burrow 1905, 1911.

¹⁸ *Brownlie v Campbell* (1880) 5 App. Cas. 925; *Rozanes v Bowen* (1928) 32 Ll. L. Rep. 98.

¹⁹ *Britton v The Royal Insurance Company* (1866) 4 F. & F. 905, 909.

²⁰ *Banque Financiere de la Cite SA v Westgate Insurance Co* [1991] 2 A.C. 249.

²¹ *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* [2007] HCA 36 Kirby J para 127.

the reason that –although rarely- if an insurer is in breach of the pre-contractual duties it would not be desirable for the assured to avoid the contract especially if the assured discovers the breach after the occurrence of the loss. As will be seen throughout this article, insurers' duty of utmost good faith becomes visible mostly at the post contractual stage including after the assured makes a claim. If the duty of utmost good faith is breached at the post contractual stage either by the assured or the insurer the MIA 1906 section 17 did not provide a satisfactory remedy for such breaches. Avoidance of the contract could create unjust results especially when there are claims paid by the insurer before the post-contractual breach took place. As a result, whilst remedy of avoidance is advantageous for insurers, the same is not necessarily the case for assured. In order to overcome such controversies it was once proposed that avoidance is appropriate to invoke in a post-contractual context in situations analogous to situations where the insurer has a right to terminate for breach.²² Whether or not this solution could resolve the problem does not require any further discussion due to the changes made by the 2015 Act but in any case this opinion was not followed by any other later cases.

Post-contractual duty of utmost good faith

No definition of 'the utmost good faith' is provided by section 17 of the MIA 1906 which appears to be unlimited in its scope.²³ The common law established that the precise definition of the term 'good faith' depends on the legal context in which it is used.²⁴ Sections 18-20 of the MIA 1906 illustrated the pre-contractual appearance of the duty of utmost good faith in relation to the representation of the risk. The duty of disclosure as defined by sections 18 to 20 only applied until the contract was made. It is undisputed that the parties are under the duty of observing the duty of utmost good faith throughout their contractual relationship.²⁵ The pre-contractual duty is material to the making of the contract itself (or some variation of it) whereas the post-contractual duty may prejudice the other party or cause him loss or destroy the continuing contractual relationship.²⁶ One illustration of the post-contractual duty of good faith is seen in *Drake Insurance Plc (In Provisional Liquidation) v Provident Insurance Plc*²⁷ in which the insurer prompted to avoid the contract for a pre-contractual non-disclosure of a material fact. The court found that if the fact in question (the speeding conviction in the previous year) had been disclosed, that would have led increase in the premium, that then would have further led by the assured to disclose some other facts (an accident the year before which was disclosed as the assured's fault whereas the assured was wholly innocent) which would have reduced the premium. Thus, there would have been no difference in the assessment of the premium if there had been full disclosure. In other words the insurers would not have been induced to enter into the contract on the facts as they were presented. The court also held that whilst there would have been no difference in outcome had there been full disclosure and the insurer knew about this at the time they attempted to avoid the

²² *K/S Merc-Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563 para 35.

²³ *The Star Sea* [2003] 1 A.C. 469 para 5, Lord Clyde.

²⁴ *The Star Sea* [2003] 1 A.C. 469 para 48 Lord Hobhouse; *Kelly v New Zealand Insurance Co Ltd* (1996) 130 FLR 97.

²⁵ *The Star Sea* [2003] 1 A.C. 469; *Overseas Commodities v Style* [1958] 1 Lloyd's Rep 546 at 559.

²⁶ *The Star Sea* [2003] 1 A.C. 469, para 52 Lord Hobhouse.

²⁷ [2004] 1 Lloyd's Rep. 268.

contract, avoidance would have been an act in bad faith; in other words breach of the duty of good faith at a post-contractual stage. Another example of breach of the duty of good faith at the post-contractual stage was observed in *Horwood v Land of Leather Ltd*²⁸ in which the assured signed a settlement agreement with the third party who is liable for the loss the assured suffered and claimed from the insurers. The settlement agreement provided that 'no further claim will be made' against the third party which would mean that there was no rights against the third party remained into which the insurer could subrogate. This was held by the court as breach of the post contractual duty of good faith as well as breach of an implied term of the contract regarding not to prejudice the insurer's subrogation rights.

There was a time at which making a fraudulent claim was regarded as breach of the post-contractual duty of good faith. This was however disapproved by later cases²⁹ and the Insurance Act 2015 codified the remedy for making a fraudulent claim by separating it from the post-contractual breach of the duty of good faith. If acting bad faith is also a proof of breach of the duty of good faith,³⁰ making a fraudulent claim may be regarded as breach of the post contractual duty of good faith but the remedy for it will be forfeiture of the contract as set out by the 2015 Act.³¹

The 2015 Act set out remedies for breach of the duty of fair presentation of the risk and clarified the remedy for making a fraudulent claim but it did not touch upon any aspects of the post-contractual duty of good faith. The repealed part of section 17 of the MIA 1906 used to express that the duty of good faith was mutually owed by the parties to a marine insurance contract. The insurer's pre-contractual duty of fair presentation of the risk does not appear in the 2015 Act. Section 3(1) of the Act expressly states that the duty is owed by the assured. This may be justified by the reason of the nature of insurance and it is rarely³² the case that the insurer may be aware of some material facts at the pre-contractual stage which should be disclosed to the assured.³³ The post-contractual duty of good faith, as mentioned above, is versatile. It is not possible to draw certain standards to define the forms that post-contractual duty of good faith appears. Two cases mentioned above indicates how diverse the breaches of post contractual duty of good faith may be from case to case.

The meaning of 'utmost' good faith

The word 'utmost' does not appear in Lord Mansfield's judgment in *Carter v Boehm* as the case reported in (1766) 3 Burrow 1905. The words 'utmost good faith' became current in the nineteenth century.³⁴ The words seem to have derived from 'uberrima fides' which was said to be that³⁵ "...if you know any circumstance at all that may

²⁸ [2010] Lloyd's Rep. I.R. 453.

²⁹ *The Star Sea* [2003] 1 A.C. 469, para 71, Lord Hobhouse.

³⁰ Lord Scott stated in *The Star Sea* that 'Unless the assured has acted in bad faith he cannot, in my opinion, be in breach of a duty of good faith, utmost or otherwise.' [2003] 1 A.C. 469 para 111.

³¹ Section 12.

³² *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2001] 2 Lloyd's Rep. 483.

³³ *Banque Financiere de la Cite SA v Westgate Insurance Co* [1991] 2 A.C. 249.

³⁴ See *The Star Sea*, [2003] 1 A.C. 469, para 47, Lord Hobhouse.

³⁵ *Brownlie v Campbell* (1880) 5 App. Cas. 925; *Rozanes v Bowen* (1928) 32 Ll. L. Rep. 98, 102; *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2003] 1 A.C. 469, para 5, Lord Clyde.

influence the underwriter's opinion as to the risk he is incurring, and consequently as to whether he will take it, or what premium he will charge if he does take it, you will state what you know.” In *Britton v The Royal Insurance Company*³⁶ Willes J expressed the duty as ‘perfect good faith’. Similarly, in *Bates v Hewitt*³⁷ Cockburn CJ described the duty as ‘full and perfect faith’. Lord Hobhouse in *The Star Sea* defined it as ‘the most extensive, rather than the greatest’ good faith.³⁸ In Australia under section 13 of the Insurance Contract Act 1984 (Cth)³⁹ it is an implied term of an insurance contract to act with the utmost good faith which is a reciprocal duty on the parties to the insurance contracts.⁴⁰ The word ‘utmost’ within this context was interpreted as to express the reciprocity; as Kirby J noted “Section 13 introduced the duty of good faith between insurer and assured on a ‘true quality of mutuality’”.⁴¹

In *Carter v Boehm* Lord Mansfield was referring to a general duty that should apply to all types of contract⁴² but as the law developed it applied only to insurance contracts. The duty was referred to as non-concealment of material facts through which fair representation of the risk would be provided. This was also to prevent fraud and to ensure that the parties have their consents to the true facts of each case. In other words openness was at the route of the principles emphasised. At the pre-contractual stage this objective can be achieved through the pre-contractual duty of fair presentation of the risk. Naturally, such duty comes to an end once the contract is made.⁴³ The scope of the duty as explained in *Carter v Boehm* is broader than simply being limited to the duties set out by sections 18-20 of the MIA 1906 or section 3 of the Insurance Act 2015. Additionally, the modern cases recognised that the duty of utmost good faith also applies outside the context of pre-contractual presentation of the risk by the assured.⁴⁴ As seen in the examples above the post-contractual duty of good faith appears in different forms in each case depending on its facts. Such duty may be argued in relation to the performance of a contractual duty, or making a claim in an honest manner,⁴⁵ or not issuing a false document to prove a matter against the insurer.

All of these matters may also be contractually arranged by the parties but a contractual provision to this effect is not absolutely necessary. The duty of utmost good faith is over and above the contractual provisions, it derives from legislation, and applies throughout the contract. In *Horwood v Land of Leather Ltd*⁴⁶ the assured’s breach in relation to the prejudicing the insurer’s subrogation rights was a breach of

³⁶ *Britton v The Royal Insurance Company* (1866) 4 F. & F. 905, 909. The judge said “The contract of insurance is one of perfect good faith on both sides, and it is most important that such good faith should be maintained.”

³⁷ (1866-67) L.R. 2 Q.B. 595, 606.

³⁸ [2003] 1 A.C. 469, para 44.

³⁹ ICA 1984 hereinafter. The Act does not apply to marine insurance or reinsurance. Section 9(1).

⁴⁰ *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* [2007] HCA 36 Kirby J para 127.

⁴¹ *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* [2007] HCA 36 Kirby J para 176.

⁴² *Brownlie v Campbell* (1880) 5 App. Cas. 925, 954 Lord Blackburn; *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501, 528 Lord Mustill; *The Star Sea* [2003] 1 A.C. 469, para 42, Lord Hobhouse.

⁴³ Insurance Act 2015 section 3(1). *Cory v Patton* (1873-74) L.R. 9 Q.B. 577.

⁴⁴ Colinvaux, para 6-006.

⁴⁵ For instance not concealing some facts from the insurer in making a claim see *Cox v Bankside Members Agency Ltd* [1995] C.L.C. 671, 680; *Royal Boskalis Westminster N.V. v Mountain* [1997] L.R.L.R. 523.

⁴⁶ [2010] Lloyd's Rep. I.R. 453.

an implied contractual term as well as a breach of the post contractual duty of good faith. The post-contractual breach of the duty of utmost good faith however may arise without a contractual breach. This is seen in *Drake Insurance Plc (In Provisional Liquidation) v Provident Insurance Plc*⁴⁷ as mentioned above. Such diverse nature of the post-contractual duty of utmost good faith renders it very hard to set any clear-cut rules. As the law stands after the 2015 Act the position is left to the common law so that courts will provide, as justice requires, the definition, scope of the duty as well as the remedy for its breach. In *Hormwood v Land of Leather* the assured lost his claim under the insurance contract because of his breach. In *Drake v Provident* the insurers were not permitted to avoid the contract for the assured's pre-contractual breach because the insurers' avoidance under the circumstances would be in breach of the their duty utmost good faith. In some jurisdictions⁴⁸ failure in making a timely response to a claim for indemnity may be regarded as breach of the post contractual duty of good faith. In English law the Courts⁴⁹ rejected the claims for damages for late payment by the insurer. The Enterprise Bill which was introduced to Parliament in September 2015 included a section which provides "It is an implied term of every contract of insurance that if the insured makes a claim under the contract, the insurer must pay any sums due in respect of the claim within a reasonable time."⁵⁰ If the Bill is enacted, the assured will be able to claim contractual damages for breach of contract in addition to a right to enforce payment of the sums due for the loss under the insurance contract and any interest on that amount.⁵¹

The post-contractual duty also varies depending on the nature of the insurance contract in question. In liability policies it is generally the case that the assured is required to transfer the control of the defence to a claim by a third party. In such a case interests of the assured and the insurers may not be the same but they will be required to act in good faith towards each other.⁵² If, for example, the limit of indemnity includes sums awarded by way of damages, interest and costs, insurers may be tempted to run up costs and exceed the policy limit to the detriment of the assured. The post-contractual duty of good faith would protect the assured by requiring the insurer to exercise his power to conduct the defence in good faith.

The insurance (or reinsurance) contract may expressly provide that the insurer shall take control of the claim against the assured "*in the spirit of good faith and fair dealing*".⁵³ This wording was held to qualify the control and power the reinsurers have under the reinsurance contract. Accordingly, the reinsurers were 'to act honestly and conscionably vis-à-vis the other parties to the contracts'. The test to determine whether insurers (or reinsurers as the case may be) are acting in a "*businesslike manner in the spirit of good faith and fair dealing*" was described as an objective test which is capable of review by a Court. If the court concludes that insurer were acting

⁴⁷ [2004] 1 Lloyd's Rep. 268.

⁴⁸ For instance in Australia : *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* [2007] HCA 36.

⁴⁹ *Sprung v Royal Insurance (UK) Ltd* [1999] Lloyd's Rep. I.R. 111; *Ventouris v Mountain (The Italia Express)* (No.3) [1992] 2 Lloyd's Rep. 281.

⁵⁰ Clause 13A(1).

⁵¹ Clause 13A(5).

⁵² *K/S Merc-Scandia XXXXII v Lloyd's Underwriters (The Mercandian Continent)* [2001] 2 Lloyd's Rep. 563 para 22.

⁵³ *Federal-Mogul Asbestos Personal Injury Trust v Federal-Mogul Ltd (formerly T&N Plc)* [2014] Lloyd's Rep. I.R. 671.

in a manner which was not “businesslike” in the spirit of good faith and fair dealing, such unbusinesslike conduct would constitute an ordinary breach of contract by insurers (for the reason that this is a contractual provision). But as seen above such a conduct is also capable of being described as against the post-contractual duty of utmost good faith.

The pre-contractual duty of utmost good faith is less elusive; its scope is two fold: the duty of disclosure and the duty not to misrepresent material facts. The test of materiality was established by the common law⁵⁴ and was codified by the Insurance Act 2015.⁵⁵ The 2015 Act also provides examples⁵⁶ of material facts and a list of facts that need not be disclosed.⁵⁷ Schedule 1 to the 2015 Act clearly set out a proportionate remedy for its breach. By such structure the duty is designed to apply at the pre contractual stage in a way capable of achieving its objectives stated above. Although the same clear operational structure is not available for the post-contractual duty of utmost good faith it is undisputed that it encompasses notions of ‘fairness, reasonableness and community standards of decency and fair dealing’.⁵⁸ In *The Star Sea* Lord Scott referred to the word ‘honesty’.⁵⁹ In emphasising the differences between the pre and post contractual duties of utmost good faith his Lordship noted that the word ‘utmost’ does not affect the point.⁶⁰ The Australian courts held that a lack of utmost good faith is not to be equated with dishonesty only.⁶¹ The absence of honesty on the part of an insurer (or assured) will attract the finding of a breach of the duty of utmost good faith however, this does not mean that a want of honesty is a universal feature of a want of the utmost good faith in this context.⁶² The High Court of Australia expressed that utmost good faith may require an insurer to act with due regard to the legitimate interests of an assured, as well as to its own interests.⁶³ The criteria of dishonesty, caprice and unreasonableness express the ambit of what constitutes a breach of the implied duty of utmost good faith.⁶⁴

It is not clear under the current wording of section 17 of the MIA 1906 when the duty of utmost good faith comes to an end. It was held in English law before the 2015 Act that once the parties become engaged in litigation, their relationship is governed by the rules of court contained in the Civil Procedure Rules which supersedes the duty of utmost good faith.⁶⁵ It was held in *The Star Sea* that when a writ is issued the rights of the parties are crystallised. The function of the litigation is to ascertain what those rights are and grant the appropriate remedy. There are important changes in the parties’ relationship that come about when the litigation starts. The battle lines have been drawn and new remedies are available to the parties under the procedural rules.

⁵⁴ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 A.C. 501.

⁵⁵ Section 7.

⁵⁶ Section 7(4).

⁵⁷ Section 3(5).

⁵⁸ *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* [2007] HCA 36, Gleeson CJ and Crennan J, para 15.

⁵⁹ *The Star Sea* [2003] 1 A.C. 469, para 102, Lord Scott.

⁶⁰ *The Star Sea* [2003] 1 A.C. 469, para 95, Lord Scott.

⁶¹ Callinan and Heydon JJ, para 257.

⁶² *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* [2007] HCA 36, para 15, Gleeson CJ and Crennan J, para 130, Kirby J.

⁶³ *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* [2007] HCA 36, para 15, Gleeson CJ and Crennan J.

⁶⁴ [2007] HCA 36, para 131, Kirby J.

⁶⁵ *The Star Sea* [2003] 1 A.C. 469, para 77.

Less controversies regarding the post-contractual duty of utmost good faith –both on the insurer and assured- arise in some other jurisdictions. Under section 13(1) of the Australian ICA 1984 (Cth) “A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.”⁶⁶

The scope of section 13(1) was discussed extensively in *CGU Insurance Ltd v AMP Financial Planning Pty Ltd*⁶⁷ in which the assured purchased a professional indemnity insurance in relation to its business that providing financial planning advice to retail investors. The business was conducted through the medium of representatives holding proper authorities. The assured had become aware of the fact that two of those representatives gave unsatisfactory financial advice to investors and informed the insurer of possible claims against it by persons who were clients of the two individuals. There followed a long period of communications between the insurer and the assured. During that period, the insurer advised the assured to act as a prudent uninsured. The assured considered that it had a liability towards a number of investors and, without any of those investors making a claim as defined under the insurance policy, proceeded to enter into settlements with those investors. The insurer however denied liability. The assured argued that the insurer’s denial of liability was a breach of the statutory requirement of utmost good faith. It is understood from the High Court’s decision that the following conducts of the insurer, in principle, might be regarded as breach of section 13(1) of the ICA 1984: (1) The insurers agreed with the assured in principle to a protocol for handling relevant claims against the assured and told the assured to act as a “prudent uninsured”. (2) Following that they allowed the processing of such claims (which necessarily had, as they knew, to be dealt with efficiently and fairly) to proceed to successive settlements over nearly two years without indicating one way or the other whether they admitted or denied indemnity. (3) The insurers also repeatedly received large amounts of material from the assured and failed to give relevant and timely responses to that material.

Nevertheless the assured was not able to enforce his action on the breach of section 13(1) for the reason that he could have but he did not try to enforce the senior counsel clause in the insurance contract.⁶⁸ The principle applied was that of “a plaintiff

⁶⁶ Section 13, before it was amended in 2013 did not used to empower a court to make a finding of liability against an insurer as a punitive sanction for not acting in good faith. As added by the Insurance Contracts Amendment Act 2013 section 13(2) of the ICA 1984 provides that “A failure by a party to a contract of insurance to comply with the provision implied in the contract by subsection (1) is a breach of the requirements of this Act.” The significance of the extension is that it becomes possible for the regulator, the Australian Securities and Investment Commission, to bring representative proceedings on behalf of an assured harmed by a breach of duty on the part of the insurer. Private enforcement is thus boosted by the possibility of the proceedings being run (and funded) by ASIC. Secondly, new s 14A of the 1984 Act extends the powers of ASIC where an insurer has failed to comply with the duty of utmost good faith in the specific contexts of the handling or settlement of claims. In that situation, s 14A authorises ASIC to exercise its regulatory powers under the Corporations Act 2001 (Cth), so that there may be administrative sanctions potentially leading to a withdrawal of authorisation. See Colinvax para 6-007.

⁶⁷ [2007] HCA 36.

⁶⁸ “(a) Unless a Senior Counsel, that We and the Insured both agree to instruct, advises that the Claim proceedings should be contested, then neither We nor the Insured can require the other to contest any legal proceedings about a Claim if the other does not agree to do so.

(b) In formulating his or her advice, Senior Counsel must be instructed to consider:

seeking relief not himself be guilty of tainted relevant conduct.”⁶⁹ The High Court expressed that “utmost good faith will usually require something more than passivity: it will usually require affirmative or positive action on the part of a person owing a duty of it”.⁷⁰ The assured seemed to have chosen either to ignore, or deliberately not to invoke, the senior counsel clause of the policies.⁷¹ The High Court held that it would have been breach of the utmost good faith if the insurer had been asked but refused to co-operate in the choice of, and obtaining of advice from, senior counsel.⁷²

Concluding thoughts

It appears that the contracts of marine and non-marine insurance are contracts based upon the utmost good faith. It is undisputed that the utmost good faith in the context of insurance contracts reflects the degrees of openness and fair dealing required of the parties in the various stages of their relationship.⁷³ Such objective is achieved at the pre-contractual stage by virtue of the duty of the fair presentation of the risk. It is however elusive at the post-contractual stage at which the openness and fair dealing appears in different forms at different types of insurance contract. In the liability insurance context for instance the insurer is expected to regard the assured’s as well as his own interests where interests of the parties are not the same (for instance where the insurers takes over the defence to the third party claim against the assured). It seems that the word ‘utmost’ does not add much to the duty to act in good faith. Several other words were used to describe the utmost nature of the duty, eg ‘perfect’ or ‘full’ duty of good faith. But what lies in the heart of the utmost good faith is not the terminology used but the manner that the parties adopt in their contractual relationship. It is submitted that if the word ‘utmost’ was omitted, the duty of good faith would, in nature, would not be interpreted as differently to the interpretations referred to above. With the word utmost or without preceding the ‘duty of good faith’ a party who prejudiced insurers’ subrogation rights is likely to be held in breach of the post-contractual duty of good faith (as well as breach of an implied term of the insurance contract). Whether utmost or otherwise, making a fraudulent claim would still be in breach of the duty of good faith remedy of which is codified by the 2015 Act. The emphasis is openness and fair dealing in ‘dealings of the parties to an

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- (i) The economics of the matter; and
 - (ii) The damages and costs likely to be recovered; and
 - (iii) The likely costs of defence; and
 - (iv) The Insured's prospects of successfully defending the claim.
 - (c) The cost of Senior Counsel's opinion is to be taken as part of the Claim Investigation Costs.
 - (d) If Senior Counsel advises that the matter should be settled and if the terms of settlement are within limits which are reasonable (in Senior Counsel's opinion and in the light of the matters he/she is required to consider), then:
 - (i) the Insured cannot (subject to Section 7.7, Insured's right to contest) object to the settlement; and
 - (ii) the Insured must immediately pay the relevant Excess or Excesses listed in the

Schedule.”

⁶⁹ [2007] HCA 36, para 257, Callinan and Heydon JJ.

⁷⁰ [2007] HCA 36, para 257, Callinan and Heydon JJ.

⁷¹ [2007] HCA 36, para 260, Callinan and Heydon JJ.

⁷² [2007] HCA 36, para 260, Callinan and Heydon JJ.

⁷³ *The Star Sea* [2003] 1 A.C. 469, para 7, Lord Clyde.

insurance contract with each other'.⁷⁴ The court would objectively assess whether the parties were open, fair, businesslike, reasonable and honest in their contractual dealings. It is also clear that it is not an absolute duty;⁷⁵ the substance of the obligation which is entailed can vary according to the context in which the matter comes to be judged.⁷⁶

⁷⁴ [2007] HCA 36, para 177, Kirby J.

⁷⁵ *The Star Sea* [2003] 1 A.C. 469, para 7, Lord Clyde.

⁷⁶ *The Star Sea* [2003] 1 A.C. 469, para 7, Lord Clyde.